BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)	CC Docket No. 01-338
	)	
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Deployment of Wireline Services Offering Advanced Telecommunications Capability	)	CC Docket No. 98-147

EMERGENCY MOTION FOR STABILIZATION ORDER

Consistent with the Federal Communications Commission's "top priority . . . to ensure that consumers do not experience any disruption in service and to provide needed stability in the marketplace,"[1] CompTel/ASCENT ("CompTel"), by its attorneys and pursuant to Section 1.41 of the FCC's Rules, 47 C.F.R. §1.41, hereby respectfully requests that the FCC immediately issue a stabilization order to remaining in effect until the FCC can adopt permanent rules on remand of the *Triennial Review Order*.[2] In exercise of its discretion to adopt interim or temporary rules, the FCC should make every effort to maintain market stability and avoid market disruption while the permanent rulemaking proceeding is pending. The FCC should also without delay conduct a proceeding to adopt permanent rules on remand.

The requested stabilization order is crucial to provide certainty in the marketplace, ensure continued uninterrupted service to consumers, and prevent competitive carriers that currently are solvent from being pushed into default through no fault of their own. The Regional Bell Operating Companies ("RBOCs") have taken the position that, since June 16, 2004, the effective

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1 *FCC Chairman Michael K. Powell Announces Plans for Local Telephone Competition Rules*, FCC Press Release, June 14, 2004.

2 *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978 (2003) ("*TRO*"), corrected by *Errata,* 18 FCC Rcd 19020 (2003), *appealed sub. nom, USTA v. FCC,* 359 F.3d 554 (DC Cir. 2004) ("*USTA II*").

date of the D.C. Circuit's *vacatur* of the *TRO*, there have not been any rules requiring RBOCs to make available switching, high-capacity loops and dedicated transport as unbundled network elements at TELRIC rates. The RBOCs have taken this position despite the FCC's finding that competitive carriers are impaired nationwide without unbundled access to local circuit switching, high capacity loops and dedicated transport,[3] and that the Court did not disturb the FCC's impairment standard itself, or its application of the impairment standard with regard to high-capacity loops.

In the absence of rules, the RBOCs can increase the costs of their competitors by raising rates for local circuit switching, high capacity loops, dedicated transport and dark fiber, and/or interfering with the ability of competitors to access and use those elements. Either RBOC action could trigger a wave of layoffs and bankruptcies. If history is any indication, the RBOCs will seek to do exactly that regardless of any voluntary commitments they may make to the FCC. Indeed, in only the 10 days since the decision by the Administration and the FCC not to seek Supreme Court review of the *USTA II* decision, the industry has seen the public announcements of market exits by UNE-P based competitors such as AT&T[4] and Z-Tel, and the announcement of layoffs by Sprint. These actions and, no doubt, many more to follow were precipitated in large part by the FCC's decision not to contest the RBOCs' "voluntary commitments," which have been interpreted by the industry as simply a commitment to raise rates after six months. The competitive carriers with the lowest direct cost of exit have begun prudently acting on the signals being sent by the RBOCs that market disruption is imminent for carriers that depend upon mass market switching.

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3 With respect to high capacity loops and dedicated transport, the FCC unanimously voted in favor of the rules appended to the TRO.

4 The RBOCs' characterization of AT&T's decision to leave the residential market in seven states as a "political statement rather than a business announcement" is the height of hypocrisy in light of the fact that they have never hidden their intent to impose significant rate increases.

Although the effects on UNE-P based carriers and the consumers they serve are as regrettable as they were predictable, these market disruptions have been well-reported by the news media, and justly so. However, CompTel is concerned that the risks confronting the rest of the competitive industry are equally, if not more, severe, and yet these risks have not received nearly the attention they deserve. Specifically, competitive resale and wholesale service providers that rely on high-capacity loops, dedicated transport, and dark fiber loops and transport face enormous risks. So, although this Motion seeks interim stability for all competitors dependant upon UNEs mandated by the TRO, the Motion focuses on the risks of market instability and interim price increases that carriers dependant on the transmission UNEs face because these risks have not received the attention in the public record that they deserve.

Thus, in light of recent events, CompTel implores the FCC to take the opportunity presented by this Motion to clarify immediately that it will not tolerate unilateral market disruption by the Bells – for any UNE – in the intervening period between vacatur of the TRO and adoption of final rules. The telecommunications industry, which relies on UNEs to provide innovative telecommunications services at competitive prices, and the citizens for whose benefit Congress adopted the 1996 Act will be irreparably harmed unless the FCC adopts the requested stabilization order until new, permanent rules can be adopted.

Finally, although CompTel is seeking emergency relief, it is not seeking extraordinary relief. All parties in this proceeding, including the RBOCS,[5] recognize that the FCC has the authority to impose temporary rules until the FCC can adopt rules which respond directly to the concerns the D.C. Circuit expressed in *USTA II*.[6] Indeed, the FCC previously has exercised its

5 *See, e.g.*, Petition of Qwest Communications International Inc. for Rulemaking, (filed March 29, 2004)(petitioning the FCC to adopt interim rules)

6 *See, e.g.*, *USTA v. FCC*, Case No. 00-1012, Reply of the FCC to Opposition of the ILEC Petitioners to Motion to Stay, 8-9 (June 3, 2004); Joint Opposition of ILECs to Motions to Stay, 1 (June 1, 2004) ("the FCC has wide discretion to adopt *interim* rules…").

authority to adopt temporary rules when prior rules have been vacated by a court.[7] Courts have upheld interim rules promulgated by the FCC as well as other federal agencies, including rules that were substantially similar to the previously vacated rules.[8] Furthermore, in accordance with the Administrative Procedure Act ("APA"), the FCC may adopt the stabilization order without advance notice and comment, because good cause exists.

I. A STABILIZATION ORDER IS NECESSARY TO PREVENT MARKET DISRUPTION AND A WAVE OF LAYOFFS AND BANKRUPTCIES

In the wake of the recent decision by the FCC and the Solicitor General not to appeal the D.C. Circuit's *vacatur* of the TRO, all of the RBOCs have committed to freeze their UNE-P rates through the end of the year. However, only BellSouth has committed to continue to provide dark fiber loops or transport past June 15th, and only SBC and BellSouth have indicated a willingness to provide access to "lit" high-capacity loops and transport service at TELRIC rates through the end of the year.[9] Therefore, competitive carriers that rely on these network elements must accept the risk that they may face significant, imminent cost increases over the next few months unless access to all UNEs is preserved at TELRIC prices pending the adoption of new final rules by the FCC.

Unless the FCC adopts the requested stabilization order, dramatic rate increases for these transmission UNEs will impact the financial viability of competitive carriers that depend on

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7 *See BOCs' Joint Petition for Wavier of Computer II Rules*, 10 FCC Rcd 1724, ¶25 (1995) ("*Computer II Decision*")(upholding agency's authority to adopt interim measures to "prevent industry disruption after agency rules have been vacated"); *see also Accounting for Judgments and Other Costs Associated with Litigation*, 12 FCC Rcd 5112 ¶ 60 (1997) ("*Accounting Decision*")(adopting "a neutral remedy" deferring costs of litigation pending resolution of the rulemaking process).

8 *See, e.g., Mid-Tex Elec. Coop. v. FERC,* 822 F.2d 1123 (D.C. Cir 1987) ("*Mid-Tex II*") (upholding interim rules that were in large part identical to the previously vacated rules); *American Fed'n of Gov't Employees, AFL-CIO v. Block*, 655 F.2d 1153 (D.C. Cir. 1981) (upholding interim rules promulgated without notice and comment).

9 Verizon's commitment apparently extends only until after the election. *See* Letter of Ivan Seidenberg, Verizon, to Chairman Michael Powell dated June 11, 2004 (committing not to increase wholesale rates unilaterally for UNE-P arrangements used to serve mass market consumers with fewer than 4 lines for five months).

these UNEs, impairing both their current capital structure and their ability to access additional capital in the future. According to the RBOCs, the new rates for the network elements will be special access rates, which represent a 2.5 to 4 fold increase over TELRIC rates, and even higher (10 fold or greater) for dark fiber, which has not retail analog. Access to these transmission UNEs at cost-based TELRIC rates is crucial because, in most areas, it is simply not possible, or feasible, for efficient competitive carriers to replicate these high-fixed cost assets (*i.e.*, loops or transport facilities).

A predictable and disastrous chain reaction will be set in motion if the RBOCs are allowed to unilaterally raise input costs to competitive carriers by a factor of 2.5 to 10 times. Any increase in the rates for DS1, DS3 loops and transport, and dark fiber loops and transport would dramatically increase the transmission costs of competitive carriers. UNE costs are typically the single largest direct cost for competitive carriers. Because of the nature of competitive markets – the prices tend toward marginal costs – competitive carriers do not earn margins substantial enough to allow them to absorb a cost increase of the magnitude that would result if rates are increased from the current TELRIC rates to the current special access rates. Given that the retail carriers will not be able to simply absorb these cost increases, the higher costs will be manifested in lower unit sales and/or margins, with the result of much lower profitability. In many cases, competitive carriers will go from being cash flow positive to cash flow negative overnight, and this will cause them to violate their credit covenants. As credit covenants are violated, credit facilities will be withdrawn and a new wave of bankruptcies will follow.

To compound these problems, CLECs with substantial amounts of sunk capital and facilities have fairly high costs of exit and cannot easily redeploy assets to different markets as their current markets become unprofitable. Even if these carriers could identify other, more promising, markets, the costs of exiting existing markets may place such a burden on current capital resources that the carriers would be foreclosed from their current access to capital and forced into bankruptcy before they could even pursue the few remaining profitable markets. Moreover, even assuming this market retreat could occur without resulting in immediate bankruptcy, the carriers must still operate under a larger debt load, comprised of sunk costs that have become stranded. For a more thorough discussion of this issue, see the attached "Declaration of M/C Venture Partners in Support of the Emergency Motion of CompTel/ASCENT."

Accordingly, the carriers that are least able to protect themselves absent regulatory intervention are those carriers which have challenged the RBOCs' pricing structure by incrementally installing facilities, capacity, and features that erode the RBOCs' long-term ability to control the prices and quality of services that end users, and other carrier customers, receive – behavior of exactly the sort that the 1996 Act sought to encourage. Therefore, unless the FCC adopts the requested stabilization order, the RBOCs will be able to thwart the 1996 Act by exercising their market power to drive competitors from the market and trigger another round of layoffs and productivity losses, which the Nation's economy cannot bear at this time.

II. A STABILIZATION ORDER WOULD RESPOND TO THE *USTA II* COURT'S CONCERNS AND PREVENT MARKET DISRUPTION UNTIL THE FCC CAN ADOPT PERMANENT RULES

The Court has repeatedly held that "[a]voidance of market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule."[10] In order to avoid market disruption, therefore, the FCC has the authority to "issue[] an interim rule while it further studies the issues to determine what rule will best promote facilities-based competition."[11] In this case, the requested stabilization order is necessary to prevent market disruption for the reasons explained above while the FCC further studies the issues to determine what rule will best promote facilities-based competition in accordance with the Court's decision in *USTA II.* Indeed, the FCC's

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10 *CompTel v. FCC*, 309 F.3d 8, 14 (2002) ("*CompTel*").

11 *Id.* at 16.

authority to adopt the requested stabilization order derives directly from the Court's mandate, which directs the FCC to adopt rules consistent with its order, the unbundling requirements set forth in section 251 of the Act, and the FCC's authority to take all actions necessary under section 4(i) of the Act.

In adopting the stabilization order requested here, the FCC may consider and adopt rules that are substantially similar to the previously vacated rules. For example, the Court in *Mid-Tex* evaluated an interim rule that a federal agency had promulgated in response to a prior court decision vacating its previous rules and remanding to the agency for further consideration.[12] In response, the agency promulgated an interim rule that *did not change* "the substance of the general provisions of the [vacated] rule."[13] However, the Court upheld the interim rule despite the fact that it was substantially similar to the vacated rule.[14] In fact, the FCC has frequently adopted temporary rules pending action on remand, even when the temporary rules do not correct each of the errors prompting the Court's remand.[15]

The FCC can respond to the Court's concerns in *USTA II* by adopting the requested stabilization order until it can conduct further rulemaking proceedings. In evaluating whether temporary agency rules are permissible, the Court has evaluated whether the rules are consistent with the underlying factual record, and whether they attempt to address the court's concerns that led to vacating the agency's prior rules. The result of the requested stabilization order would be the application of rules that are based on the impairment standard adopted by the FCC and the

12 *See Mid-Tex Elec. Coop., Inc. v. FERC,* 773 F.2d 327 (D.C. Cir. 1985).

13 *Mid-Tex II* at 1124 (quotation omitted).

14 *Id.* at 1131.

15 *See, e.g., Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* FCC Oct. 3, 2003, n.160 (adopting interim rules pending effective date of permanent rules and noting that "it is well established in the courts that avoidance of market disruption pending broader reforms is a standard and accepted justification for a temporary rule.") ("*Pay Phone Order*"); *Computer II Decision* at ¶25 (noting authority to adopt interim measures to "prevent industry disruption after agency rules have been vacated").

underlying record developed at the FCC in the triennial review proceeding, which supports a finding of nationwide impairment for high-capacity loops and dedicated transport. Specifically, the underlying record in the proceeding – which the Court did not challenge – demonstrates that competing carriers are impaired nationwide without unbundled high-capacity dedicated transport (DS1, DS3, and dark fiber). Similarly, the impairment standard adopted by the FCC – which equates impairment with barriers to entry – was also upheld by the Court. In the TRO, for example, all four FCC Commissioners and the Chairman voted to continue to require that incumbents provide competitors with access to unbundled high-capacity loop and dedicated transport network elements, because requesting carriers would in both cases face formidable barriers to entry without access to these elements. In fact, Chairman Powell emphasized the need to allow competitors to "continue to receive access to high-capacity loops,"[16] and Commissioner Abernathy stated that competitors' continued access "to the bottleneck transport and loop elements [is] critical to the continued development of facilities-based competition."[17] As such, it is critical that the FCC maintain unbundled access to these network elements as contemplated and supported in the TRO until new, permanent rules can be adopted, particularly since the Court in the *USTA II* decision did not base its decision to vacate the rules in any part due to concern about the record in the underlying proceeding.

The stabilization order would also respond directly to the concerns that led the Court to vacate the FCC's rules in *USTA II*. The Court in *USTA II* vacated the FCC's high-capacity dedicated transport rules, finding, *inter alia*, that the FCC had unlawfully delegated its authority to state commissions.[18] The requested stabilization order would directly address this concern by ensuring that determinations of impairment are made at the federal level. In any event, the

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16 *See TRO, Separate Statement of Chairman Powel* at 1.

17 *See id., Separate Statement of Commissioner Abernathy* at 1.

18 *USTA II* at 574 ("the Commission may not subdelegate its § 251 authority to state commissions."). The Court also faulted the FCC for not explaining why competition on one route was not sufficient to demonstrate competition on a different route and for not exploring an alternative to a route-by-route analysis. *See id.* at 575.

stabilization order would be limited in duration until the FCC adopts further rules in this proceeding. Therefore, the requested stabilization order is consistent with the precedent of the Court and the FCC and is necessary to prevent market disruption until new rules can be adopted.

III. THE FCC HAS THE AUTHORITY TO ADOPT A STABILIZATION ORDER WITHOUT ADVANCE NOTICE AND COMMENT

The FCC has good cause to adopt the requested stabilization order without advance notice and comment, because the harms outlined above will occur before the FCC could provide notice and receive comment, and providing notice and the opportunity to comment on the stabilization order would merely delay the FCC's efforts to conduct further rulemaking proceedings. Pursuant to section 553(b)(3)(B) of the APA, 5 U.S.C. § 553(b)(3)(B), the FCC may promulgate rules without advance notice and comment if it "for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." In applying this standard, the Court has held that good cause exists to adopt interim rules without advance notice and comment when (1) the rules are temporary; (2) the underlying record in the proceeding supports the temporary rules; and (3) delay in adopting permanent rules on remand would be contrary to the public interest.[19] The FCC in fact has adopted interim rules without advance notice or comment (in some cases with little support) in response to a court vacatur.[20]

Good cause exists to adopt the stabilization order requested in this case because (1) the rules would be in effect only on an interim basis until further rules can be adopted on remand, (2) the stabilization order would require application of rules that are consistent with the underlying record developed before the FCC and at the state commissions as a result of the TRO, and (3) the

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19 *See, e.g., Mid-Tex II* at 1131-32.

20 *See, e.g., CompTel,* 309 F.3d 8; *Pay Phone Order* (adopting interim payphone compensation rules substantially similar to the vacated rules until OMB approved new rules); *see also Computer II Rules* (reinstating rules after vacatur); *Accounting Decision* (adopting interim rules regarding the accounting treatment of certain litigation costs).

absence of rules – or a delay in adoption of rules – would be contrary to the public interest and could result in financial consequences and regulatory confusion. Furthermore, it would be impractical and unnecessary to provide advance notice and comment for a stabilization order that would only be in place until the FCC can adopt further rules. Therefore, the FCC has good cause to adopt the requested stabilization order without advance notice and comment.

IV. CONCLUSION

For the foregoing reasons, CompTel/ASCENT urges the FCC immediately to adopt a stabilization order until it can adopt further rules, and to conduct a rulemaking to do so as soon as possible.

Respectfully submitted,

COMPTEL/ASCENT

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Dated: June 24, 2004

CERTIFICATE OF SERVICE

I, Beatriz Viera-Zaloom, hereby certify that on this 24th day of June 2004, a true and correct copy of the foregoing **Emergency Motion for Stabilization Order**, on behalf of CompTel/ASCENT, was delivered via courier and email upon the following:

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DECLARATION OF M/C VENTURE PARTNERS IN SUPPORT OF THE EMERGENCY MOTION OF COMPTEL/ASCENT

1. My name is Peter H. O. Claudy. I am a General Partner in the private equity firm of M/C Venture Partners ("M/C" or "M/C Ventures") 75 State Street, Boston, MA 02109. M/C Ventures is a private equity firm, specializing in providing early stage equity capital to telecommunications and information technology firms. Currently, through our three active funds, M/C has over $1 billion of equity capital under management, the large majority of which is invested in competitive telecommunications carriers. M/C has been actively involved in the telecommunications sector for over 20 years, and has been a pioneer in the financing of competitive carriers in the local exchange marketplace. One example of our early involvement in this sector is that we were the largest, and first, venture capital investor in Brooks Fiber Communications; making our investment in 1993.

2. While M/C Ventures is always evaluating new investment opportunities on behalf of both its limited partners, and its existing portfolio companies, M/C is currently focused on managing primarily four substantial portfolio companies in the competitive telecommunications service provider sector. Three of these companies, NuVox Communications, Cavalier Telephone, and Florida Digital Network, are retail CLECs offering integrated communications services (local and long distance voice and data) to residential and small/medium business customers. One other major portfolio company, City Signal Communications, provides dark fiber to other, primarily competitive, telecommunications carriers. While M/C Ventures understands the importance, and value, of minimizing its portfolio companies' reliance on incumbent local exchange carrier ("ILEC") unbundled network elements ("UNEs"), all of our portfolio companies have some critical dependence on ILEC UNEs.

3. The purpose of this declaration is to provide evidentiary support for the Emergency Motion of CompTel/ASCENT ("CompTel"), of which some of our portfolio companies are members. It is our understanding that, in the wake of the recent decision by the FCC and the Solicitor General not to appeal the D.C. Circuit's *vacatur* of the Commission's *Triennial Review Order* ("TRO"), all of the Regional Bell Operating Companies ("RBOCs") have committed to freeze their UNE-P rates through the end of the year. On the other hand, of the RBOCs, only BellSouth has committed to continue to provide dark fiber loops or transport past June 15th, and only SBC and BellSouth have indicated a willingness to provide access to "lit" high-capacity

loops and transport service at TELRIC rates through the end of the year. Thus, we anticipate that, unless CompTel's Emergency Motion is granted, the RBOCs will attempt to impose on most of our portfolio companies significant, imminent cost increases over the next few months.

4. M/C Ventures concurs generally with CompTel's request that access to all UNE's (for which the Commission in the TRO found met the impairment standard) be preserved at TELRIC prices pending the adoption of new final rules by the Commission. The purpose of my declaration is to explain the likely consequences of a near-term price increase on those firms that rely on access to high-capacity loops and transport, including dark fiber. Specifically, I will explain how dramatic rate increases (from TELRIC to special access) for these transmission UNEs will impact the financial viability of these firms by impairing their profitability and capital structure, and their access to capital in the future.

5. M/C Ventures has, by and large, focused our investments on competitive local exchange carriers ("CLECs") that are network-based, meaning that our CLEC portfolio companies provide services by using a substantial amount of their own switching and transmission equipment, and in many cases their own fiber transmission media. Nonetheless, because it is not possible to replicate certain high-fixed cost assets (*i.e.*, loops) and it is not feasible to replicate others (*i.e.*, transport facilities) in most areas, all of our portfolio companies are critically dependent on cost-based access to these network elements. Indeed, cost-based access to expensive-to-replicate portions of the incumbent

monopoly network, as guaranteed by the Telecommunications Act of 1996, is a fundamental premise for the substantial capital investment undertaken by our firm.

6. The network-based communications service providers in which we invest are extremely capital-intensive firms. As a private equity investor, we fund a substantial portion of our portfolio companies' capital requirements. However, private equity investors do not provide all of the capital required by competitive communications providers. Typically, private equity comprises only a portion of the total investment needed to fund a fiber-based, or switch-based competitive telecommunications provider. Therefore, in making a decision to initially fund, or continue to fund an enterprise, it is extremely important to private equity investors that the firm be able to attract and maintain access to debt capital. Because debt capital demands returns that are lower than the returns sought by private equity, the presence of debt allows the firm to meet its funding requirements in a more cost efficient manner than simply relying on private equity. Firms that have a significant amount of debt on their balance sheet are referred to as "levered" or "leveraged" based on the potential leverage in return to equity holders for a given investment.

7. All investors, be they private equity or debt investors, seek to minimize risk -- particularly within a risky sector such as competitive telecommunications. Private equity investors seek to limit their risk by maintaining an active role in directing how a firm will do business. However, debt investors do not—simply by the nature of their investment--have daily input into what the firm is

doing, or should be doing. Therefore, because debt financiers generally do not "own" any portion of the portfolio company, they cannot minimize their risk through the same manner of control used by the equity owners. Debt investors preserve their legal rights and protect their investors' capital through the use of credit arrangements and lending covenants.

8. Credit arrangements typically entitle the borrower to "draw down" a line of credit until the maximum amount of credit is borrowed. However, in order to continue to be able to access the credit facility, the borrower must meet certain, pre-set "covenants," or performance targets. These targets are normally common barometers of financial performance such as revenue, gross margins (revenue minus cost of goods sold), EBITDA (earnings before interest, taxes, depreciation, and amortization) and capital expenditures. Covenants can also include industry-specific targets such as access line count.

9. If a borrower "violates" a covenant by failing to achieve the performance targets, the lender can typically cancel the credit facility and demand immediate repayment of the borrowed amount. Such recourse would have disastrous consequences for the borrower, because when a lender terminates a credit facility, the borrower is effectively foreclosed from accessing the credit markets. In our experience, once a bank has terminated a credit facility, other banks will not extend credit, absent a restructuring of debt, an equity infusion, or both.

10. Our main concern is the significant risk that a predictable, but avoidable, chain reaction will be set in motion if the RBOCs are allowed to unilaterally

raise input costs to already-levered firms by a factor of 2.5 to 10 times present costs. Simply put, we are concerned that the Commission appears poised to passively allow the RBOCs to unilaterally raise rates by several hundred percent. By failing to act to prevent these price increases, the Commission will take a heretofore solvent, performing carrier and push that carrier into default with the stroke of a pen. This, in-turn, could easily spark a "domino effect" within the facilities-based segment of the competitive telecommunications industry.

11. Based on our knowledge of the finances of our portfolio companies, any price increases on DS1, DS3 loops and transport, and dark fiber loops and transport will impose dramatic cost increases—for example, a tripling of transmission costs. These network elements, purchased by our portfolio companies, generally comprise their single largest direct cost component. It is, therefore, easy to understand that a substantial cost increase for a major input will likely have negative effects on every performance target included in our credit facilities.

12. Similarly, based on our familiarity with retail market conditions in which our portfolio companies compete with other CLECs and the ILEC for retail sales, we are not aware of many, if any, CLECs that are earning margins substantial enough to allow the firms to absorb a cost increase of the magnitude contemplated by a switch from TELRIC to special access rates. Given that the retail carriers will not be able to simply absorb these cost increases, the higher costs will be manifested in lower sales and much lower profitability or

actual losses. In many cases, these firms may go from being cash flow positive to cash flow negative overnight. We believe that, as credit covenants are violated and credit facilities withdrawn, a new wave of bankruptcies can be reasonably anticipated if the Commission fails to act.

13. Another important feature of the firms that have entered the market by committing substantial amounts of capital into facilities is that these firms (as distinguished from firms which use more of the RBOC network) have fairly high costs of exit and cannot re-deploy assets to different markets if current markets become unprofitable. Even if these carriers could identify other, more promising markets, it is more than likely the costs of exiting existing markets, along with the costs of continuing to carry the debt associated with the now-stranded investment, would cause these firms to go bankrupt and completely exit the market.

14. Thus, from an investor's perspective, it is fairly easy to understand that by allowing the RBOCs to unilaterally, and substantially, increase the cost structure for the most capital-intensive competitive telecommunications carriers, the Commission—acting on the apparent advice of the NTIA—could introduce artificial cost increases that will have ruinous effects throughout the interconnected telecommunications industry. Ironically, the firms that are least able to protect themselves absent regulatory intervention, are those firms that have threatened the BOC's pricing structure through the incremental installation of facilities, capacity, and features.

15. As I have explained, it is the committed entrants that are least able to strategically withdraw from markets and cannot implement a low cost market exit plan. If the Commission does not grant CompTel's Motion, these firms—who provide innovative services and diverse, alternative infrastructure—will be the means through which the RBOCs impose another round of layoffs and productivity losses which will be born unfairly by competitors and small/medium business customers. Finally, if the Commission were to allow the mass exit of competitive capital investment through its failure to regulate the behavior of bottleneck monopolies, it should go without saying that investment capital will never return to the competitive industry.

16. I declare that the foregoing statements are true and correct to the best of my knowledge, information and belief.

Peter H O Claudy

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Dated: 6/24/04